Internal Revenue Service
memorandum

Index Number 58.10-00
Control Number TR-45-674-91

date: MAY 17 1991

to: Dallas ~~Technical Coordinator~~ District
Dallas District

from: Chief, Branch 6 (Income Tax and Accounting) CC:IT&A:06

subject: This letter is in response to your request for technical assistance dated April 22, 1991, with respect to the issue stated below.

ISSUE

How does the tax benefit rule of section 58(h) apply in a situation in which a taxpayer has a net operating loss carryback to a taxable year in which the taxpayer has tax preference items for both the section 56 minimum tax (MT) and the section 55 alternative minimum tax (AMT).

FACTS

We previously addressed this issue with respect to these taxpayers in a prior technical assistance memorandum (TR-45-1259-89). Subsequent to the issuance of that memorandum you discovered that there were some errors in the data submitted with the original technical assistance request. You have requested that we make new computations based on the revised data. In general, once the legal standards for making computations have been set forth, we believe the field has the primary responsibility to make computations based on those legal standards. However, because of the complexity of the computations required in this particular case, and because we have already developed the computer software to make the computations required in this particular case, we believe the most efficient course of action is for us to make the revised computations in accordance with your request. We will not repeat the legal analysis previously set forth in TR-45-1259-89.

Taxpayers are married calendar year taxpayers who filed a joint return and had the following items for [redacted]:

Wages	$ [redacted]
Interest Income	[redacted]
Dividends	[redacted]
Gains Reported on Form 4797	[redacted]

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Net Capital Gain	[redacted]
Income Reported on Schedule C	[redacted]
Depreciation Adjustment	[redacted]
Section 1202 Deduction	[redacted]
Schedule E Loss	[redacted][1]
Marital Deduction	[redacted]
AGI Not Taking Into Account Any NOL Deductions	$ [redacted]

Not taking into account any adjusted gross income (AGI) limitations on deductions, Taxpayers had the following itemized deductions and personal exemptions for [redacted]:

Medical Expenses		
Drugs	$[redacted]	
Other	[redacted]	
		$ [redacted]
Taxes		[redacted]
Interest		[redacted]
Contributions		
Cash	$[redacted]	
Carryover	[redacted]	
		[redacted]
Total Itemized Deductions		$ [redacted]
Personal Exemptions		[redacted]

[1] Revised from a loss of $[redacted] per the original assistance request, an increase in the Schedule E loss of $[redacted]. From this point onward when we indicate that something is revised, it is to be understood as revised from the original assistance request.

Taxpayers had a NOL carryover from the taxable year ending[2] [redacted], to the calendar year ending [redacted], of $[redacted][3]. A portion of the NOL carryover to [redacted], $[redacted], was attributable to tax preference items (preferences) for percentage depletion, $[redacted] and $[redacted] of such preferences attributable to Taxpayers' taxable years ending [redacted] and [redacted] respectively. All of the [redacted] NOL carryover was absorbed in [redacted]. In [redacted], Taxpayers also had a $[redacted] preference for percentage depletion. Taxpayers had a NOL in [redacted], but elected, under section 172(b)(3)(C) of the Internal Revenue Code, to carry the NOL forward. In [redacted], Taxpayers had a NOL of $[redacted] that they carried back to [redacted]. The entire [redacted] NOL was absorbed in [redacted]. With respect to [redacted], the entire amount of the [redacted] NOL is treated as non-preferential.

After taking into account the NOLs from [redacted] and [redacted], Taxpayers had no regular tax liability in [redacted]. As of [redacted], Taxpayers had the following investment tax credits (ITCs) that could have been carried either back or over to [redacted]:

Year Credit Earned	Amount of Credit
[redacted]	$[redacted]

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[2] Prior to [redacted], Taxpayers were on a fiscal year ending in November. On [redacted], Taxpayers converted to a calendar year. Taxpayers filed a short period return for the month of [redacted]. Part of the NOL that Taxpayers incurred for the taxable year ending [redacted], was absorbed on the short period return and part of the NOL was absorbed in prior taxable years. The $[redacted] figure is the amount left over for carryover to [redacted] after taking into account prior absorptions.

[3] Revised from $[redacted], an increase in the NOL carryover to [redacted] of $[redacted].

[4] Revised from $[redacted] an increase in [redacted] preferences of $[redacted], which is also equal to the increased Schedule E Loss for [redacted].

[5] Revised from $[redacted].

[6] Revised from $[redacted].

[redacted]	[redacted][7]
Total	$ [redacted][8]

As of [redacted], Taxpayers had the following ITCs that could have been carried either back or over to [redacted]:

Year Credit Earned	Amount of Credit
[redacted]	$ [redacted][9] [10] [11]
Total	$ [redacted][12]

All of the credits are attributable to an active trade or business. For taxable years beginning prior to [redacted] the reduction in credits between [redacted] and [redacted] is attributable to dispositions of section 38 property that occurred in [redacted].

Taxpayers' chapter 1 tax liability is the minimum chapter 1 tax liability for all possible combinations of preferences. The first step to determine what portion of the Taxpayers' preferences are beneficial is to determine what Taxpayers' AGI would have been in the absence of any preferences, determined as follows:

Wages	$ [redacted]
Interest	[redacted]
Dividends	[redacted]
Gains (Form 4797)	[redacted]

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[7] Revised from $[redacted].

[8] Revised from $[redacted], a decrease of $[redacted].

[9] Revised from $[redacted].

[10] Revised from $[redacted].

[11] Revised from $[redacted].

[12] Revised from $[redacted], a decrease of $[redacted].

Net Capital Gain	[redacted]
Business Income (Sch C)	[redacted]
Depreciation Adjustment	[redacted]
Loss (Sch E)	[redacted]
Marital Deduction	[redacted]
[redacted] Percentage Depletion Preference	[redacted]
Non-Preferential Portion of Net Operating Loss Carryover to [redacted]	[redacted]
[redacted] NOL Carryback To [redacted]	[redacted]
Non-Preference AGI	$ [redacted]

Three computations of minimum chapter 1 tax liability are required. First we will compute what Taxpayers' minimum chapter 1 tax liability would have been without any ITCs. Secondly, we will compute Taxpayers' minimum chapter 1 tax liability taking into account ITCs that were available to be used in [redacted] as of the end of [redacted]. Although Taxpayers did not file a refund claim for [redacted] based on a [redacted] carryback, [redacted] is still an open tax year and is part of the examination. Furthermore, as of the close of [redacted] Taxpayers had more ITCs that were available to be used in [redacted] than they had at the close of [redacted]. Thus, our final computation will be to compute Taxpayers' minimum chapter 1 tax liability for [redacted] taking into account ITCs available as of the close of [redacted]. This final computation is Taxpayers' actual [redacted] income tax liability after taking into account all possible carrybacks. Taxpayers' [redacted] chapter 1 tax liability as of the close of [redacted] is computed so you may take it into account for interest computation purposes.

The difference between the minimum chapter 1 tax liability with and without the ITCs is the tax savings attributable to the ITCs. Without any ITCs, Taxpayers minimum chapter 1 tax liability occurs at a point at which Taxpayers' TAMT[13] is equal to Taxpayers' MT and Taxpayers' AGI has been reduced to a point at which Taxpayers are able to use all of their medical expenses as deductions. Taxpayers' minimum chapter 1 tax liability without ITCs occurs when Taxpayers use $[redacted] of MT preferences. At the point of minimum chapter 1 tax liability Taxpayers' AGI is zero or negative. Taxpayers' taxable income is negative and Taxpayers'

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[13] For our purposes TAMT is equal to alternative minimum taxable income (AMTI) times the appropriate AMT tax rates.

regular tax is zero.[14]

MT Preferences		$ [redacted]
MT Deduction		
Taxable Preferences		[redacted]
MT		$ [redacted]
Non-Preference AGI		$ [redacted]
MT Preferences		
Itemized Deductions:		
Medical		
Drugs $ [redacted]		
Other		
	$ [redacted]	
Taxes		
Interest		
Charitable Contributions		[redacted]
Personal Exemptions		
AMTI		[redacted]
		20%
		[redacted]
Tax on AMTI Between $20,000 And $60,000		[redacted]
TAMT		$ [redacted]

If ITCs are taken into account the minimum chapter 1 tax liability occurs at the point at which the regular tax is just

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[14] At first glance, it might seem that Taxpayers chapter 1 tax liability would be at a minimum at the point at which TAMT is equal to MT and only enough preferences are used to reduce Taxpayers' regular tax to zero. However this is not the case. If only enough preferences are used to reduce the regular tax to zero, Taxpayers will have a positive AGI and will not be able to use all of their medical expense deductions for AMT purposes. The only impact of using additional 1202 deduction is to decrease TAMT by reducing AGI and allowing a greater medical expense deduction for AMT purposes. Thus, at a negative taxable income fewer MT preferences are necessary and Taxpayers' chapter 1 tax liability is lower.

large enough so that all available ITCs may be used against the regular tax and the TAMT less the MT and regular tax is equal to the CAMT[15]. For $[redacted] of ITCs, that were available to be used in [redacted] at the close of [redacted], this point occurs when MT preferences are equal to $[redacted], and the section 1202 deduction is equal to $[redacted]. The minimum chapter 1 tax liability at this point is computed as follows:

Computation of Regular Tax

Non-Preference AGI		$[redacted]
1202 Deduction		
MT Preferences		
AGI		[redacted]
Itemized Deductions		
Medical	$ -	
Taxes	[redacted]	
Interest		
Contributions		
ZBA		[redacted]
Personal Exemptions		
Taxable Income		$[redacted]
Regular Tax Before ITC		$[redacted]
Computation of 46(a)(3) Limitation:		
Regular Tax Before ITC	$[redacted]	
	[redacted] %	
	[redacted]	
Allowable ITC		[redacted]
Regular Tax		$[redacted]

Computation of MT

MT Preferences	$[redacted]
Regular Tax	
Deduction For [redacted] and [redacted] Preferences	

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15 See page 14 of TR-45-1259-89 for the definition of CAMT.

Taxable MT Preferences	[redacted]
MT	$ [redacted]

Computation of AMT Before Credit

Non-Preference AGI	$ [redacted]
MT Preferences	[redacted]
Total Itemized Deductions	[redacted]
Personal Exemptions	[redacted]
AMTI	[redacted]
Less First $60,000 AMTI	(60,000)
AMTI Taxable at 20 Percent	[redacted]
	20%
	[redacted]
Tax on AMTI Between $20,000 And $60,000	[redacted]
TAMT	$ [redacted]
Regular Tax	[redacted]
MT	[redacted]
AMT Before ITC	$ [redacted]

Computation of CAMT

AMTI	$ [redacted]
Adjusted Itemized Deductions	-
Less Net Capital Gain $ [redacted] /60%	[redacted]
CAMTI	[redacted]
Less First $60,000 CAMTI	[redacted]
CAMTI Taxable at 20 Percent	[redacted]
	20%
	[redacted]
Tax on CAMTI Between $20,000 And $60,000	[redacted]
CAMT Before 46(a)(3) Limitation	$ [redacted]
CAMT Before 46(a)(3) Limitation	$ [redacted]

	[redacted]
CAMT	$ [redacted]

For purposes of determining the amount of ITC allowable against the AMT, the ITCs are grossed up by the lesser of the ITC allowed against the regular tax ($[redacted]) or the AMT before the allowable ITC ($[redacted]). In this case that number is $[redacted] which is also equal to the CAMT. Thus, Taxpayers may use $[redacted] of ITCs to eliminate the entire amount of their AMT liability. This means that Taxpayers' chapter 1 tax liability is equal to the sum of their regular tax and MT computed as follows:

Regular Tax	$ [redacted]
MT	
[redacted] Chapter 1 Tax Taking Into Account ITCs Available at the Close of [redacted]	$ [redacted]

The $[redacted] tax liability computed above is not what Taxpayers owe for [redacted] as of today. Their actual chapter 1 tax liability based on ITCs available for use in [redacted] that were available at the close of [redacted] is slightly lower. However, this is their [redacted] tax liability at the close of [redacted] and this should be taken into account for interest computation purposes.

For $[redacted] of ITCs, that were available to be used in [redacted] at the close of [redacted], the minimum chapter 1 tax occurs when MT preferences are equal to $[redacted] and the section 1202 deduction is equal to $[redacted]. The chapter 1 tax liability at this point is computed as follows:

Computation of Regular Tax

Non-Preference AGI		$ [redacted]
1202 Deduction		
MT Preferences		
AGI		[redacted]
Itemized Deductions		
Medical	$ [redacted]	
Taxes		
Interest		
Contributions		
ZBA		
Personal Exemptions		[redacted]
Taxable Income		$ [redacted]

Regular Tax Before ITC	$ [redacted]
Computation of 46(a)(3) Limitation:	
Regular Tax Before ITC $[redacted]	
[redacted]	
[redacted]%	
[redacted]	
Allowable ITC	[redacted]
Regular Tax	$ [redacted]
<u>Computation of MT</u>	
MT Preferences Regular Tax Deduction For [redacted] and [redacted] Preferences	$ [redacted]
Taxable MT Preferences	[redacted]
	[redacted]%
MT	$ [redacted]
<u>Computation of AMT Before Credit</u>	
Non-Preference AGI MT Preferences Total Itemized Deductions Personal Exemptions	$ [redacted]
AMTI	[redacted]
Less First $60,000 AMTI	(60,000)
AMTI Taxable at 20 Percent	[redacted]
	20%
	[redacted]
Tax on AMTI Between $20,000 And $60,000	[redacted]
TAMT Regular Tax MT	$ [redacted]
AMT Before ITC	$ [redacted]

Computation of CAMT

AMTI	$ [redacted]
Adjusted Itemized Deductions Less Net Capital Gain $[redacted]/60%	[redacted]
CAMTI	[redacted]
Less First $60,000 CAMTI	(60,000)
CAMTI Taxable at 20 Percent	[redacted]
	20%
	[redacted]
Tax on CAMTI Between $20,000 And $60,000	[redacted]
CAMT Before 46(a)(3) Limitation	$ [redacted]
CAMT Before 46(a)(3) Limitation	$ [redacted]
CAMT	$ [redacted]

For purposes of determining the amount of ITC allowable against the AMT the ITCs are grossed up by the lesser of the ITC allowed against the regular tax ($[redacted]) or the AMT before the allowable ITC ($[redacted]. In this case that number is $[redacted] which is also equal to the CAMT. Thus, Taxpayers may use $[redacted] of ITCs to eliminate the entire amount of their AMT liability. This means that Taxpayers' chapter 1 tax liability is equal to the sum of their regular tax and MT computed as follows:

Regular Tax MT	$ [redacted]
[redacted] Chapter 1 Tax Taking Into Account ITCs Available at the Close of [redacted]	$ [redacted]

After taking into account all possible carrybacks as of the close of [redacted], Taxpayers' minimum [redacted] chapter 1 tax liability based on all possible combinations of ITCs and preferences is $[redacted]. However, the ITCs that could have been used in [redacted] in the absence of preferences were not actually used in [redacted]. Thus, some adjustment must be made to ensure that Taxpayers do not get a double tax benefit by using the ITCs for a section 58(h) adjustment in [redacted], and then using the ITCs to offset regular taxes in future taxable years. Taxpayers' ITC carryovers should be reduced by $[redacted], the difference between Taxpayers' minimum chapter 1 tax liability for [redacted] without ITCs ($[redacted]) and Taxpayers' [redacted]m chapter 1 tax liability for [redacted] with $[redacted] of ITCs ($[redacted]). Reduction in Taxpayers' ITC carryover allows the Service to effectively recapture the deferred tax liability attributable to the ITCs in any taxable year in which Taxpayers are subject to the regular tax and would have otherwise been able to use ITCs to offset that regular tax in the absence of credit reduction. Furthermore, section 1.58-9T(e) of the temporary regulations makes it clear that for purposes of computing ITC recapture under section 47 of the Code, a credit reduction is treated the same as if the credit had been used to offset regular tax liability. A similar rule should apply to the instant case. The allocation of the credit reductions should be made as set forth in technical assistance memorandum TR-45-1259-89.

Taxpayers have not had much opportunity to use the ITCs freed up by the preferences that were used in [redacted]. However, early dispositions of section 38 property have taken place in taxable years subsequent to [redacted] that are still open. Thus, you should look at those taxable years to determine if any ITC recapture is due from Taxpayers as a result of the section 58(h) adjustment in [redacted].

If you have any questions regarding this technical assistance memorandum please call Forest Boone at FTS 566-3861.